

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:03

PLR-106516-21

Date:

September 15, 2021

Legend:

X: =

A: =

B: =

C: =

State =

Country: =

Date 1: =

Date 2: =

Date 3: =

Dear _____ :

This letter responds to a letter dated March 3, 2021, and subsequent correspondence submitted on behalf of X by its authorized representatives requesting rulings under §§ 1362(b)(5) and 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was incorporated on Date 1 under the laws of State. X intended to be an S corporation effective Date 1. However, X's Form 2553, Election by a Small Business Corporation, was not timely filed.

On Date 2, A, a U.S. citizen, acquired shares of stock in X. At that time, A was (and is still) married to B, a citizen and resident of Country. Country is a community property jurisdiction such that B is considered to own an interest in the stock of X on Date 2. As a citizen of Country who is not residing in the U.S., B, a nonresident alien, was an ineligible S corporation shareholder. Consequently, had X's S corporation election been effective Date 1, it would have terminated on Date 2. Upon discovering that X had an ineligible S corporation shareholder, B signed an agreement transferring her interest in the stock of X to A.

On Date 3, X entered into an agreement with C, a shareholder in X, to purchase additional shares of stock in X. The agreement contained an anti-dilution provision with respect to C's shares in X such that C would maintain a fixed ownership percentage in X. X represents that the agreement is a governing provision within the meaning of § 1.1361-1(l)(2)(i) of the Income Tax Regulations and that the effect of the anti-dilution provision in the agreement caused X to have more than one class of stock. Consequently, had X's S corporation election been effective Date 1, it would have terminated on Date 3. Upon learning that it had more than one class of stock, X amended the agreement with C pursuant to which the anti-dilution provision was stricken, and B's ownership interest was adjusted to exclude the application of the anti-dilution provision.

X states that X and its shareholders have filed their federal income tax returns consistent with X having a valid S corporation election in effect as of Date 1. X represents that the circumstances resulting in the termination of its S corporation election under § 1362(f) were inadvertent and not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1.1361-1(l)(1) provides, in part, that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions).

Section 1362(b)(1) provides that an election under § 1362(a) may be made by a small business corporation for any taxable year (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the third month of the taxable year.

Section 1362(b)(3) provides that if (A) a small business corporation makes an election under § 1362(a) for any taxable year and (B) the election is made after the 15th day of the third month of the taxable year and on or before the 15th day of the third month of the following taxable year, then such election shall be treated as made for the following taxable year.

Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)), after the date prescribed by § 1362(b) for making such election for such taxable year or no § 1362(a) election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat such an election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small

business corporation. Section 1362(d)(2)(B) further provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or (B) to acquire the shareholder consents; and (4) the corporation for which the election was made or the termination occurred and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X has established reasonable cause for failing to make a timely election to be an S corporation effective Date 1. Thus, we conclude that X is eligible for relief under § 1362(b)(5). Accordingly, if X makes an election to be an S corporation by filing a completed Form 2553 with the appropriate service center effective Date 1, within 120 days from the date of this letter, then such election will be treated as timely made. A copy of this letter should be attached to the Form 2553 filed with the service center.

In addition, we conclude that had X's S corporation election been effective Date 1, it would have terminated on Date 2 when X had an ineligible S corporation shareholder. Also, we conclude that had X's S corporation election not terminated on Date 2, it would have terminated on Date 3 as a result of X having more than one class of stock. We further conclude that the circumstances resulting in the terminations on Date 2 and Date 3 were inadvertent within the meaning of § 1362(f). Thus, X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided X's S corporation election is otherwise valid and has not otherwise terminated under § 1362(d).

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion on whether X is otherwise eligible to be treated as an S corporation.

These rulings are directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that the rulings may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the rulings requested, it is subject to verification on examination.

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy for § 6110 purposes

cc: